because of natural-monopoly-related impairment does the second step — setting or evaluating the price for the unbundled element — come into play.[58]

Thus, the unbundling determination in the statute hinges on whether the "failure to provide access to such network elements" would, "at a minimum," impair a competitor seeking to provide a telecommunications service, *not* on whether a competitor should be given a particular price for network elements to which it already has access.[59] When Congress got around to the issue of prices for network elements, it left such prices to be negotiated between the ILEC and its competitor in the first instance,[60] but provided that in the absence of an agreement the price would have to be cost-based.[61]

The statutory test for whether unbundling was to occur made no mention of price. Only after an impairment finding is made and unbundling required does the price of an unbundled element become relevant. Given the Supreme Court's recognition that the word "cost" is a "chameleon" with no single clear meaning,[62] Congress could not have intended that a determination of impairment would depend upon whether a given UNE can be obtained at some particular cost-based price (*i.e.*, TELRIC). It intended that a determination be made whether a competitor would be impaired *without access* to a particular network element via unbundling, not whether a competitor would be better off with a lower price for a network element that is already available.

(footnote continued)
if they have to pay the higher of the two. Under that test, everything could be a UNE forever, everywhere. The D.C. Circuit correctly described such logic as "circular." *USTA II*, 359 F.3d at 577.

58 *See Verizon*, 535 U.S. at 476, 491-2.

59 *See* 47 U.S.C. § 251(d)(2).

60 *See* 47 U.S.C. § 252(a)(1).

61 *See* 47 U.S.C. § 252(d)(1).

62 *See Verizon*, 535 U.S. at 500.

Thus, the TELRIC price has no relevance to a determination whether a carrier is impaired by not having access to a particular network element as a UNE.[63] Congress was trying to make available what was *not* otherwise available; it was not seeking to reprice network elements that are already available. The test is whether a carrier is impaired by the ILEC's "failure to provide access to such network elements,"[64] not whether a carrier is impaired by the price for an available network element.

Consistent with this principle, the *First Local Competition Order* was premised on CLECs' "ability to purchase" elements, not their ability to get them at particular prices,[65] and it made its unbundling determinations (albeit using a standard that did not comply with the statute) without regard to the price for unbundled elements, which it then set as TELRIC. The Commission acknowledged that the issue is whether the ILEC should be required to "provide the facility or functionality of a particular element to requesting carriers, separate from the facility or functionality of other elements, for a separate fee."[66] The decision of whether competing carriers were impaired with respect to a network element was not premised on whether that element was priced at or near TELRIC. That approach was correct and should be followed here as well.

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63 Impairment cannot be determined simply by comparing the costs of inputs, but can only be found by observing the relationship between wholesale costs and retail prices. If the retail price is less than cost, then competitors may not be able to compete but that does not constitute impairment under the statute. The burden is on the competitor to demonstrate it cannot achieve the margins necessary to succeed, given the retail prices it must charge for all the services it provides and that it is the cost of the network element, and not the level of retail prices, that creates the impairment. In short, the FCC would have to determine that competition would be precluded by reliance upon a tariffed offering or other alternative source of a network element before it could proceed to require unbundling of the ILEC's network element.

64 47 U.S.C. § 251(d)(2)(B).

65 *First Local Competition Order,* 11 F.C.C.R. at 15706, para. 411.

66 *Id.,* 11 F.C.C.R. at 15635, para. 268.

E. There Can Be No Impairment When Competing Carriers Can, and Do, Obtain a Network Element through Means Other than Section 251 Unbundling

USTA II makes clear that impairment cannot be found where a substitute for a given network element is already available and in use in a competitive market without being unbundled pursuant to Section 251. A network element cannot be subject to Section 251 unbundling (at TELRIC or any other price) if the functional equivalent of the requested UNE can be self-provisioned or third-party provisioned, can be obtained from a competing carrier (including the ILEC) pursuant to a commercial contract filed under Section 211(a) of the Act, or can be obtained under a tariff where there is evidence that competitors are taking advantage of such alternatives in the marketplace already.

1. Self-Provisioning or Third-Party Provisioning

The Commission must consider whether the requested network element is, or can be made, available to a given carrier through self-provisioning or third-party provisioning. In making this determination, the Commission needs to consider whether the network element is characterized by natural monopoly characteristics — *i.e.*, whether "the element is one for which multiple, competitive supply is unsuitable."[67] The mere fact that a newcomer faces entry barriers or has higher costs than an incumbent, as in any business, is not the kind of impairment that the statute was intended to remedy.[68] The Act does *not* give the FCC the power to ease competitive entry by competitors in the absence of impairment.

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67 *USTA I*, 290 F.3d at 427.

68 *See id.* ("To rely on cost disparities that are universal as between new entrants and incumbents in *any* industry is to invoke a concept too broad, even in support of an *initial* mandate, to be reasonably linked to the purpose of the Act's unbundling provisions.")

This crucial fact is often overlooked. For example, the EarthLink line-sharing *ex parte* letter provides an excellent example of misanalysis of the impairment standard. It links every economic hardship the company faces in the provision of Internet service to an imagined impairment standard with no connection to the standard set forth in the statute.[69] *USTA II* made clear that the purpose of unbundling is to facilitate facilities-based competition that would be impeded by obstacles related to natural monopoly characteristics, and "*not* . . . to guarantee competitors access to ILEC network elements at [TELRIC prices]."[70] The unbundling provisions of Section 251 were intended to overcome natural monopoly obstacles, not to provide CLECs with every possible leg up in competing with the ILEC at the ILEC's expense — as the D.C. Circuit remarked, "In competitive markets, an ILEC can't be used as a piñata."[71]

The *USTA II* Court found that network elements that had become available from alternative sources were not subject to unbundling — even if these sources had come into being only because of a previous unbundling requirement.[72] For example, it endorsed the Commission's determination of no impairment with respect to certain databases, because "CLECs evidently have adequate access to call-related databases," due to the "abundance of alternative providers."[73]

This is fully in keeping with the principle established by the case law that a network element need only be unbundled due to impairment if the network element has natural monopoly characteristics that would effectively prevent an alternative source of supply of that network

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69 *See* Letter to Marlene H. Dortch, FCC, dated Aug. 10, 2004 from Donna N. Lampert and Mark J. O'Connor, counsel to Earthlink, Inc., filed in CC Dockets 01-338 *et al.*

70 *USTA II*, 359 F.3d at 576 (emphasis added).

71 *USTA II*, 359 F.3d at 573.

72 *USTA II*, 359 F.3d at 587.

73 *USTA II*, 359 F.3d at 588. The Court noted that if the situation changed, and such databases became unavailable, "affected parties may petition the Commission to amend its rule." *Id.*

element.[74] Obviously, if there are already alternate sources of supply, whether from the ILEC or from other sources, there is no "natural monopoly" preventing a requesting carrier from obtaining the needed network element.

2. Availability Under ILEC Commercial Intercarrier Agreements

Negotiated intercarrier contracts and agreements provide a means for a competing carrier to obtain facilities and capabilities from an ILEC on terms that are commercially reasonable. No carrier can be considered impaired if it can get a needed network element from the ILEC at commercially reasonable rates[75] pursuant to a nondiscriminatory agreement.

Section 211 of the Act has, since 1934, specifically provided for intercarrier contracts and agreements.[76] The 1996 Act, however, takes this one step further and, in the words of Justice Thomas, "sets up a preference for negotiated . . . agreements."[77] Thus, the Commission has recognized the benefits associated with carriers reaching commercially negotiated solutions on issues of network access and interconnection. In fact, the Commission strongly urged carriers to negotiate agreements regarding unbundled elements in the wake of *USTA II*.[78] Accordingly, the *Order and NPRM* lauded parties who have successfully negotiated agreements, stating that the

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74 *See* Section I.C, *supra.*

75 As discussed herein, the rates for particular network elements cannot be construed to create impairment. Nonetheless, to the extent the Commissions deems rates relevant, the existence of commercially negotiated agreements demonstrates that carriers have arrived at mutually agreeable rates that permit competitors to offer the services they seek to provide.

76 47 U.S.C. § 211.

77 *Iowa Utilities,* 525 U.S. at 405 (opinion of Justice Thomas, concurring in part and dissenting in part).

78 FCC News Release, *Press Statement of Chairman Michael K. Powell and Commissioners Kathleen Q. Abernathy, Michael J. Copps, Kevin J. Martin, and Jonathan S. Adelstein on Triennial Review Next Steps,* released March 31, 2004 ("[W]e ask all carriers to engage in a period of good faith negotiations to arrive at commercially acceptable agreements for the availability of unbundled network elements. . . . After years of litigation and uncertainty, such agreements are needed now more than ever. . . . Today, we come together with one voice to send a clear and unequivocal signal that the best interests of America's telephone consumers are served by a concerted effort to reach a negotiated agreement.") (*Press Statement*). *See also Separate Statement of Commissioner Kathleen Q. Abernathy on Order and NPRM,* released August 20, 2004 ("I applaud the efforts of those carriers that have already reached commercial deals regarding the price and other terms of such access, and I encourage others to do so.").

Commission "support[s] such negotiations," and indicated further that the Commission "specifically craft[ed] these interim requirements to minimize the risk that they might nullify existing agreements or foreclose future agreements."[79] Notably, Qwest's "QPP" agreement, which was negotiated in response to the Commission's post-*USTA II* request, was one of the agreements identified by the Commission in its *Order and NPRM.*[80]

Thus, the Commission must determine whether the network element can readily be obtained through a *bona fide* commercial agreement available from the ILEC on a nondiscriminatory basis. All five Commissioners have taken the "clear and unequivocal" position that "the best interests of America's telephone consumers are served by a . . . negotiated agreement" for the provision of network elements.[81] If the Commission were to require Section 251 unbundling, at TELRIC prices, for a network element available in that manner, it would thus be acting contrary to consumers' interests as well as violating the express terms of Section 251.

The fact that a network element is available to any potential competing carrier by entering into a commercial agreement that is available to all on nondiscriminatory terms and used by numerous carriers in a competitive market *precludes* a finding of impairment. The fact that competing entities have entered into such agreements is conclusive evidence that the elements supplied under it are available for use at reasonable terms in accordance with the parties' business judgment. Such agreements must be filed with the Commission[82] and may not be unjustly or unreasonably discriminatory.[83] As a result, such agreements completely dispose of any claims of impairment, and the Commission cannot refuse to consider them, given the Court's require-

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79 *Order and NPRM* at para. 21 n. 58.

80 *Id.*; *id.* at ¶ 7, n.23. *See* Section III.A.4 below for a discussion of the QPP agreement that Qwest has reached with major carriers such as MCI as well as many smaller carriers.

81 *See Press Statement.*

82 47 U.S.C. § 211.

83 47 U.S.C. § 202.

ment to consider the potentially dispositive effect of "alternatives offered by the ILECs."[84] Thus, if a given ILEC's standard commercial agreement has been executed by a variety of competing carriers and the same agreement is available to other competing carriers on a nondiscriminatory basis, the network elements covered by the agreement are readily available to an entire range of similarly situated carriers as well. Such an agreement is dispositive of the impairment issue, without any need for further analysis, because it establishes that network elements are readily available on commercially reasonable terms and are being used.

3. Availability from ILEC Under Tariff

Several times in its *USTA II* opinion, the Court held that any finding of impairment was precluded where a competitive industry has been able to develop without reliance on a network element being unbundled pursuant to Section 251. The fact that the network element could be, and was, obtained and used without unbundling was dispositive.

First, the Court held that wireless carriers who were able to provide service successfully using special access facilities obtained under tariff were not impaired because they could get the same functionality as their desired UNE, although not at TELRIC prices. It specifically rejected the position that the availability of the same facilities under the special access tariff was irrelevant to the impairment determination[85] and held "that the Commission's impairment analysis must consider the availability of tariffed ILEC special access services when determining whether would-be entrants are impaired."[86] Second, the Court held that CLECs successfully using transport and high-capacity loops under wholesale special access tariffs are not impaired by being denied access to those same network elements as UNEs at TELRIC prices, stating that "the pres-

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84 *USTA II*, 359 F.3d at 577.

85 *USTA II*, 359 F.3d at 575-77.

86 *Id.*, 359 F.3d at 577.

ence of robust competition in a market where CLECs use critical ILEC facilities by purchasing special access at wholesale rates, *i.e.*, under § 251(c)(4), *precludes a finding that the CLECs are 'impaired'* by lack of access to the element under § 251(c)(3)."[87]

Competing carriers have long been able to obtain a variety of facilities and capabilities offered under tariff pursuant to Section 203.[88] *USTA II* made clear that when a competitive industry has been able to develop using tariffed special access instead of UNEs, there can be no finding that such carriers are impaired: "[C]ompetitors cannot generally be said to be impaired by having to purchase special access services from ILECs, rather than leasing the necessary facilities at UNE rates, where robust competition in the relevant markets belies any suggestion that the lack of unbundling makes entry uneconomic."[89] Thus, the general availability of tariffed facilities and their use in lieu of the UNE to compete with the ILEC requires a finding of non-impairment.[90] As a result, when a given network element is already available by itself at an FCC-regulated price, and the marketplace has shown that the tariffed facility can be used successfully by providers of a given service, the Commission is not free to order "unbundling" of that very network element, repriced at TELRIC, to such providers.[91] There simply is no basis for an impairment finding.

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87 *Id.*, 359 F.3d at 593 (emphasis added).

88 47 U.S.C. § 203.

89 *USTA II*, 359 F.3d at 592.

90 This is true even if the network element is one that would be considered to have natural monopoly characteristics associated with its construction and deployment. The fact that it is available under tariff makes the network element available to all, rather than to the company possessing the facility with monopoly characteristics. The Act uses tariff regulation as its principal means for making monopoly services and facilities available to all on a nondiscriminatory basis.

91 The *First Local Competition Order* dodged the dispositive effect of the availability of special access under tariff only by engaging in a bit of dissimulation. It refused to permit consideration of tariffed facilities and services as a way of obtaining network elements, for purposes of the impairment analysis, because it claimed that tariffed facilities and services were not equivalent to UNEs because of differences in jurisdictional classification. Tariffed special access and transport, it reasoned, were jurisdictionally either intrastate or interstate and this jurisdictional classification placed significant limits on the traffic that they could handle, while UNEs are nonjurisdictional and can be used to carry both interstate and intrastate traffic indiscriminately. *See First Local Competition Order* 11
(footnote continued)

Yet that is precisely what the Commission has done in the past. The equivalence of tariffed special access and transport to UNEs has been well established. In its *Supplemental Order Clarification,* the Commission adopted policies (subsequently replaced in the *TRO* by rules that were vacated in *USTA II*) premised on its recognition that tariffed special access and transport are the "functional equivalent" of the unbundled loop and transport network elements.[92] The rules adopted in the *TRO* encouraged interexchange carriers to convert their tariffed facilities to UNEs solely to reap the benefits of TELRIC pricing with the FCC's blessing. A rethinking of this premise is doubly important now that the Court has explicitly required the FCC to recognize the availability of tariffed services in its impairment analysis and has confirmed that interexchange services are not eligible for UNE purchase.[93]

Moreover, requiring unbundling as a network element of a service or functionality already available from ILECs under a tariff would have the perverse effect of *discouraging* competitive supply because of TELRIC pricing — leading to the absurd result of unbundling only because the FCC's pricing scheme artificially impairs the development of facilities-based competition. The *USTA II* court noted that one effect of very-low-cost TELRIC pricing could also be to undermine the ability of ILECs to provide services priced at or below cost.[94]

(footnote continued)
F.C.C.R. at 15499, 15716, 15721, paras. 436, 448. In fact, the FCC has long held that special access and transport facilities classified as interstate can carry intrastate traffic and vice versa. A given facility can carry as much as 90% intrastate traffic and still be jurisdictionally interstate. *MTS and WATS Market Structure,* CC Docket 78-72, *Decision and Order,* 4 F.C.C.R. 5660 (1989) (*Ten Percent Order*). Thus, the only reason cited by the Commission for holding special access and transport nonequivalent to UNEs for purposes of impairment is invalid. In practice, more than XXX of Qwest's special access circuits are purchased from interstate, rather than intrastate, tariffs (based on August 2004 DS1 and DS3 revenue).

92 *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket 96-98, *Supplemental Order Clarification,* 15 F.C.C.R. 9587, 9588-89 (2000) (*Supplemental Order Clarification*), *aff'd sub nom. Competitive Telecommunications Association v. FCC,* 309 F.3d 8 (D.C. Cir. 2002).

93 *USTA II,* 359 F.3d at 575-77, 592-93; *see also Competitive Telecommunications Association v. FCC,* 309 F.3d 8 (D.C. Cir. 2002).

94 *USTA II,* 359 F.3d at 573.

F. The "At a Minimum" Clause Requires FCC Consideration of Other Factors Relevant to the Objectives of the Act If it Finds Impairment Exists, Before Deciding Whether to Unbundle

In a portion of the *TRO* affirmed by the D.C. Circuit, the Commission properly considered the existence of relevant countervailing factors after it made a finding that competitive providers would be impaired by a lack of access to unbundled hybrid loops.[95] The Court found that this was a proper analysis:

> The CLECs rightly point to *USTA I*'s observation that "impairment" was the "touchstone," 290 F.3d at 425, but that opinion, far from barring consideration of factors such as an unbundling order's impact on investment, clearly read the Act, as interpreted by the Supreme Court in [*Iowa Utilities*], to mandate exactly such consideration.[96]

The Commission should follow a similar approach here if and when it finds impairment to exist. Any unbundling inquiry needs to take into consideration the effects of unbundling vis-à-vis the other goals of the Act. These include investment in facilities-based competition, innovation, deployment of advanced services, and effect on universal service.

As the Court has made clear, the Commission can consider such costs either in narrowing the scope of impairment or in making the unbundling determination after finding impairment to exist.[97] There are two types of such costs to society: the "administrative" costs of undertaking unbundling (*i.e.*, the societal cost of the proceedings necessary to make the necessary determinations, with the uncertainties and delays that such proceedings entail) and the cost to society of

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95 *TRO*, 11 F.C.C.R. at 17148, para. 286.

96 *USTA II*, 359 F.3d at 580, (*citing Iowa Utilities*, 525 U.S. at 427-28).

97 *USTA II*, 359 F.3d at 572.

foregoing the investment and innovation by both the ILECs and CLECs when unbundling removes incentives to engage in facilities-based competition.[98]

Moreover, if the Commission finds impairment, unbundling is not the only possible result. The unbundling of a network element at TELRIC prices is a draconian measure, which disincents both the ILEC and the CLEC to engage in innovation, investment, and facilities-based competition and upsets the presumptions on which local telephone rates are founded.[99] Accordingly, the "at a minimum" clause requires the Commission to consider as countervailing factors not only the cost to the ILEC of unbundling but also the cost to society, as measured by the objectives of the 1996 Act. Unbundling at very low prices, such as TELRIC, may make the use of UNEs more attractive than facilities-based competition, disserving the statutory objective. This has already happened with respect to switching.[100] Other costs of unbundling that need to be considered in this analysis are the effect of unbundling in areas where below-cost retail rates are mandated, the effects on universal service, and the adverse consequences in the context of other goals of the Act. The Commission has properly concluded that a finding of some degree of impairment need not lead to unbundling, where there are other factors the Commission cannot overlook, such as the need to promote investment in advanced telecommunications services.[101] Unbundling should be reserved for those situations where there is a record demonstrating actual impairment, as mandated by the Act, *and* a careful weighing of the costs and benefits results in a reasoned conclusion that unbundling is necessary.

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98 *See Iowa Utilities,* 525 U.S. at 428-29 (Breyer, J., concurring in part and dissenting in part). Financial harm to ILECs cannot be ignored, either. No matter how TELRIC is viewed in other contexts, it is clear that, if an ILEC priced all or most of its services at TELRIC, it could not survive as an economically viable entity.

99 These include the ability to earn a sufficient profit on some services to maintain affordably-priced basic residential service while keeping rates at a just and reasonable level overall.

100 *UNE Fact Report 2004, submitted by BellSouth, SBC, Qwest and Verizon, WC Docket No. 04-313 and CC Docket No. 01-338, filed Oct. 4, 2004,* § II, p. 47 (*UNE Fact Report*).

101 *TRO,* 18 F.C.C.R. at 17141-46, paras. 272-280.

G. Impairment and Unbundling Decisions Must Be Made by the Commission, but Must Also Account for Pertinent Differences Among Parts of the Country

USTA II makes clear that only the Commission, not state regulators, can make determinations of impairment and require unbundling. But both *USTA I* and *USTA II* also make clear that the Commission may not ignore relevant regional or other differences and require unbundling more widely than is warranted by the actual extent of any impairment.

The statute permits unbundling to be ordered *only* in situations where the Commission finds that there is impairment, based on a factual record. Accordingly, the Commission cannot order unbundling nationwide if the evidence shows impairment in some places but not others. The Court has required a more "nuanced" approach, so that unbundling will be ordered *only* where there is impairment.[102] A nationwide unbundling requirement is not lawful if the evidence shows there are areas where there is no impairment.[103]

There are several ways to perform this more "granular" analysis. The Commission could decline to find impairment nationwide with respect to a network element, and then conduct region-by-region, state-by-state, or case-by-case proceedings as needed to determine whether there is evidence of impairment in each given area. The administrative problems with such an approach are obvious, and drove the Commission to attempt to delegate the granular determinations to the states in the *TRO,* resulting in the *USTA II* vacatur. Alternatively, the Commission can evaluate the evidence provided in the instant proceeding to determine whether there are any unique characteristics of particular parts of the country that justify a finding of impairment and

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102 *See USTA I,* 290 F.3d at 426; *USTA II,* 359 F.3d at 569.

103 *See USTA II,* 359 F.3d at 569 ("the (no longer provisional) national impairment finding [is] inconsistent with our conclusion in *USTA I* that the Commission may not 'loftily abstract[] away from all specific markets,' . . . but must instead implement a 'more nuanced concept of impairment.'").

require an unbundling determination, while other areas, where evidence is not presented supporting an impairment finding, would not require any unbundling of the network element in question.

Given the requirements of the statute, the Commission cannot proceed from the premise that unbundling will be ordered in all instances except in areas where ILECs demonstrate a lack of impairment. It may order unbundling *only* in areas where impairment is shown to exist. And as to some network elements, it may be — and in fact is — impossible to find impairment as a matter of law, nationwide.

II. INTERMODAL COMPETITION HAS CHANGED THE REGULATORY LANDSCAPE

Since the 1996 Act became law, there have been huge changes in the telecommunications world. Competition has come about through the development of technological alternatives that were only dimly foreseen at that time. The result is widespread "intermodal" competition,[104] which requires the Commission to address unbundling issues more carefully. It makes no sense to place regulatory burdens on one set of providers for the benefit of another set of providers, when there is a third way for the latter to proceed that does not require the unbundling of network elements.

A. Intermodal Competition in the Provision of Traditional Mass Market Voice Services Has Expanded

Competition in the provision of voice services is no more evident than in Qwest's region, where cable telephony competitors, initially using traditional circuit-switched technology, have

[104] Some forms of competition by means of alternative technologies, such as circuit-switched telephony provided by cable companies, could be described as "intramodal," in that it simply uses a different method for delivering a service that is architecturally similar to traditional telephone service, while other services are truly intermodal, such as VOIP-based cable telephony, because they differ in both technology and architecture. Because the boundaries between the two tend to be blurred, we will refer to all such competition as "intermodal" in this discussion.

taken as much as xxxx the market in certain areas served by Qwest.[105] In fact, competition in the Omaha MSA is so fierce that Qwest has been supplanted as the largest provider of telephone service in the market.[106] Indeed, Qwest has filed a petition with the FCC seeking forbearance from dominant carrier regulation in that market.[107] As that petition explains, cable operator Cox is providing cable-based telephony throughout the market, including the provision of service to more than 7,500 commercial customers,[108] and Cox reports that its penetration rate is over 50 percent of its basic cable customer base.[109] Facilities-based competitors such as AllTel and McLeod also serve the market using their own networks, and have overbuilt Qwest's legacy network.[110] And the use of new technologies such as VoIP is intensifying the level of intermodal competition, as discussed in the next section. It must be kept in mind that this is all occurring in Nebraska, which is the thirty-seventh largest state in terms of population.

Qwest's changed market position has not gone unnoticed. Noting that Qwest has been hardest hit by the surge of competition, one recent report states: "Qwest has lost three million lines since the end of 2000, including 200,000 in the second quarter alone. At that rate, Qwest is losing an estimated $200 million in high-margin revenue each year . . . ."[111] This intermodal competition also has more broadly impacted all ILECs. ILECs have lost significant numbers of customer lines, as well as traffic and revenue shares, to CLECs and cable companies (as well as to VoIP and wireless providers), and those figures continue to grow dramatically. RBOC voice

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105 Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160, Docket No. WC-04-223, filed June 21, 2004, pp. 3-4 (*Qwest Omaha Forbearance Petition*).

106 "U.S. Phone Industry Faces Upheaval as Calling Changes," K. Brown and A. Latour, Wall Street Journal, Aug. 25, 2004.

107 *Qwest Omaha Forbearance Petition.*

108 *Id.*, p. 8.

109 *Id.*, n. 23.

110 *Id.*, p. 9.

111 "U.S. Phone Industry Faces Upheaval as Calling Changes," K. Brown and A. Latour, Wall Street Journal, Aug. 25, 2004.

lines represent less than 60 percent of all local access points used by residential customers for voice and data services.[112] Well over half of residential customers already use a wireless or data network for at least some of their voice service needs.[113]

As of mid-2004, competitors were serving in excess of 3 million customers (largely mass market customers) using their own switches together with unbundled ILEC loops.[114] Those switches would be serving even more customers but for subsidized retail rates and artificially low prices for UNE-P.[115] Competitors are serving these mass market customers through UNE-L arrangements in at least 137 of the top 150 MSAs, which contain nearly 70 percent of the U.S. population, in wire centers that account for over 87 percent of the access lines in those MSAs.[116] A recent report notes that cable phone service subscribership already is at 3.6 million households, and is expected to rise to 11.6 million by the end of 2008.[117]

B. Vibrant Intermodal Competition Also Has Developed in the Provision of Mass Market Voice Services via Broadband IP-Based Architectures

The advent of VoIP technology has made intermodal competition in the voice service market not only possible but potentially devastating to companies that rely solely on existing circuit-switched technologies to face the future. Indeed, one of the most significant challenges the

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112 *UNE Fact Report*, §I, p. 4.

113 *Id.*

114 *Id.*, §I, p. 5; *Id.*, §II, p. 37.

115 *Id.*, §I, p. 5; §II, pp. 46-47 ("Assuming conservatively an average capacity of 50,000 lines per switch, the approximately 1,200 circuit switches that competing carriers have deployed are capable of serving approximately 65 million voice-grade equivalent lines. Yet competing carriers report to the FCC that they are serving fewer than 10-11 million voice-grade equivalent lines using their switches. An association of UNE-P providers notes, '[t]here is little question that excess local switching capacity exists in many markets.'") (internal citations omitted). "UNE-P" is short for "UNE Platform," a combination of UNEs that replicates all of the functionalities involved in providing local exchange service, including loops, transport, and switching; it essentially involves resale of the ILEC's service.

116 *UNE Fact Report*, §II, p. 44. The term "UNE-L" refers to telephone service provided by using UNE loops and CLEC switching.

117 "Mediacom to Sell Phone Service Over Cable in Deal With Sprint," J. Drucker and P. Grant, Wall Street Journal, Aug. 25, 2004, p. D3.

ILECs face is that from broadband voice services offered by cable operators and VoIP service providers. When the *TRO* was released, mass market voice service over broadband facilities was not viewed as a competitive threat to ILECs due to the perceived technological and cost impediments to broad deployment. That has changed. VoIP is being touted as the "killer app" for broadband.[118] Analysts project that cable operators will capture 10 percent of current residential lines by 2007 and over 15 percent by 2008.[119] In Roanoke, where Cox first introduced VoIP service, it reports penetration increasing as quickly as in markets where it offers circuit-switched service — markets where Cox's penetration now averages 20 percent and rises as high as 55 percent.[120] Cablevision has been adding VoIP subscribers at a rate of 3,400 per week in the New York metropolitan area.[121] Charter plans to offer VoIP phone service to one million homes by the end of the year, and already serves 31,000 phone customers.[122] Recent reports reflect that Vonage, the largest of the new IP-based providers, already serves over 225,000 customers, and is adding over 25,000 lines per month.[123] And, VoIP providers are reporting large profit margins — estimated at 40-45 percent for Cablevision, and at 70 percent (headed to 80 percent) for Vonage.[124] Analysts estimate that cable operators will have cash flow margins of approximately 40 percent for their VoIP services.[125] Indeed, if Cox could win over 50 percent of the market using circuit switching, the prospects are unlimited for cable companies offering voice services with VoIP, given the higher profit margins associated with the new technology.

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118 *UNE Fact Report*, §II, p. 4.

119 *Id.*, §II, p. 8.

120 *Id.*, §II, p. 9.

121 *Id.*

122 *Charter's Vogel: VOIP Partnerships Are Economical Choice*, E. Sheng, Dow Jones Newswires (Sept. 9, 2004).

123 "VoIP Vs. Conventional Telephones," D. Ewalt, Forbes.com, Aug. 23, 2004.

124 *UNE Fact Report*, §II, p. 16.

125 *Id.*

There is widespread agreement that VoIP presents a serious alternative to traditional local exchange companies — one recent report saying that it is "increasingly clear that in the battle of VoIP versus circuit switching, the conventional system is on the ropes. It's no longer a question of whether VoIP will supplant conventional phone systems, but when."[126] Another report called the "jack in the wall that connects to the phone company's network...just a useless hole."[127] Here, too, Qwest has felt the brunt of this competition. In Qwest's Omaha market, at least seven VoIP providers, including AT&T, 5 Star Telecom, Packet8, VoicePulse, BroadVoice and Zip-global, provide telephony services.[128] And, another recent report indicates that cable operator Mediacom will partner with Sprint to offer phone service to 2.7 million households that it reaches in 23 states containing markets of varying size, including many rural areas. The report notes that the ILEC likely to be hit hardest by this new service is Qwest, since Qwest serves 26% of the markets served by Mediacom.[129]

ILECs generally are feeling the impact of this new competition, which has undercut so many of the assumptions on which the Commission has based its past unbundling orders. Recent reports indicate that the RBOCs have lost 28 million phone lines (18 percent) since the end of 2000 — the first time there has been a decline since the Great Depression.[130] The RBOCs are losing 4 percent of their residential lines per year to competitors like cable giants Cablevision (115,000 phone subscribers in just over 7 months in its New York region) and Cox (1.1 million

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126 "VoIP vs. Conventional Telephones," D. Ewalt, Forbes.com, Aug. 23, 2004 (emphasis added).

127 "U.S. Phone Industry Faces Upheaval as Calling Changes," K. Brown and A. Latour, Wall Street Journal, Aug. 25, 2004.

128 *Qwest's Omaha Forbearance Petition*, p. 12.

129 "Mediacom to Sell Phone Service Over Cable in Deal with Sprint," J. Drucker and P. Grant, Wall Street Journal, Aug. 25, 2004, p. D3.

130 "U.S. Phone Industry Faces Upheaval as Calling Changes," K. Brown and A. Latour, Wall Street Journal, Aug. 25, 2004.

Internet and traditional phone customers).[131] And, more VoIP competitors are expected — "anyone who wants to go into the business can do it" according to the CEO of 8x8, Inc., the VoIP provider using the Packet8 name.[132] For a mere $25,000 investment, Covad will provide the entire set of services needed to start a VoIP business.[133]

Competition from wireless services also has had a significant impact on Qwest. As Qwest reported in its forbearance petition, wireless subscribership within the State of Nebraska (reported to be 900,744) exceeds ILEC subscribership (775,829 lines in service), and wireless service options are available from at least one CMRS provider in every Qwest wire center within the Omaha MSA.[134] CMRS carriers serving the Omaha MSA include Verizon Wireless, Sprint, AllTel, Cricket, Nextel, U.S. Cellular and MCI.[135] Wireless competition also has impacted ILECs generally. Over 14 percent of consumers use their wireless phone as their primary phone, and over 7-8 percent have given up wireline service completely.[136] Analysts predict that within four years, approximately 22 million access lines will be displaced by wireless.[137] ILEC access lines are decreasing, while wireless carriers are adding about 20 million subscribers per year.[138]

C. Intermodal Competition for Broadband Services Is Also Flourishing

The market for broadband services is so competitive that RBOCs offering DSL service hold a minority market position. According to the Commission's own data, 58 percent of residential and small business customers receiving 200 kbps service subscribe to cable modem ser-

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131 *Id.*

132 *Id.*

133 *Id.*

134 *Qwest Omaha Forbearance Petition*, p. 10.

135 *Id.*

136 *UNE Fact Report*, §II, pp. 28, 30.

137 *Id.*, §II, p. 29.

138 *UNE Fact Report*, § II, p. 7.

vice, as opposed to just 34 percent that subscribe to DSL.[139] Of customers receiving more than 200 kbps service in both directions, more than three-quarters subscribe to cable modem service, and only 15 percent to DSL.[140]

The Commission has recognized that additional competition in the provision of broadband services is rapidly being developed and provided via alternate networks including wireless and powerline.[141] Fixed wireless broadband service has been deployed in over 70 MSAs, up from zero in 1996 and 58 in 2002.[142] And, over 90 percent of U.S. homes also have access to two-way satellite data services, up from zero percent in 1996.[143]

D. Substantial Intermodal Competition, Even at the Retail Level, Eliminates the Basis for Unbundling

In considering whether unbundling may lawfully be required in a particular market, the Commission must give full and often decisive weight to the presence of competition in a market, even though it comes from an intermodal competitor. When an ILEC has lost a substantial portion of the market to competitors, the Commission cannot require unbundling in that market.

It cannot be seriously argued that competitors are entitled to unbundled network elements even when the ILEC faces significant competition from multiple sources, so long as the competition exists at the retail level. Such a position is contradicted by the requirement that unbundling be supported by the natural monopoly characteristics of a market. A highly competitive market cannot, by definition, be a natural monopoly market. The Act was not devised as to protect a specific competitor or type of competitor, but to protect competition and consumers. The argu-

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139 *Availability of Advanced Telecommunications Capability in the United States*, Fourth Report to Congress, FCC 04-208, GN Docket No. 04-54, rel. Sept. 9, 2004, p. 29.

140 *Id.*

141 *Id.*, pp. 18-23.

142 *UNE Fact Report*, § I, p. 2.

143 *Id.*

ment that intermodal competition is irrelevant, or at least diminished, because it does not necessarily provide CLECs with wholesale access to telecommunications facilities, is simply dead wrong.[144] The Commission has already recognized that the existence of significant retail competition from other sources makes it unnecessary to mandate unbundling and may even result in less effective competition, and the Court has agreed.[145]

Once a market is characterized by substantial competition, the benefits of unbundling are surely outweighed by the costs of such unbundling, even if an impairment finding could be made with regard to a particular CLEC. Indeed, with each competitive opportunity made available to customers, the relative benefits of unbundling decrease and the relative costs increase. Ultimately, the goal of the Act is to provide choices to end user customers, not CLECs. The loss of substantial market share by an ILEC to an intermodal competitor demonstrates conclusively that end users view the intermodal competitor as a viable alternative to the ILEC. In this case, the unbundling of the ILEC's network in that market provides little additional benefit. Furthermore, under the current regulatory regime, intermodal providers inherently possess the ability to differentiate their services more from the ILEC than can a provider that is offering its services over the ILEC's network. Also, the unbundling of the ILEC's network offers proportionally less benefit to a CLEC when an ILEC has lost substantial market share.

144 *See USTA II,* 359 F.3d at 572-73; *USTA I,* 290 F.3d at 429; *Iowa Utilities,* 525 U.S. at 389.

145 *See TRO,* 18 F.C.C.R. at 17135-36, paras. 260-63; *USTA II,* 359 F.3d at 584-85.

III. MASS MARKET SWITCHING CANNOT BE CLASSIFIED AS AN UNBUNDLED NETWORK ELEMENT

A. There Can Be No Finding of Impairment for Mass Market Switching

The *USTA II* decision mandates a finding of no impairment for mass market switching on a nationwide basis. As described in the following sections, lack of access to switching on an unbundled basis does not satisfy the standard for impairment as set forth in *USTA II*. The existence of competition (both from circuit-switched CLECs and from intermodal sources such as VoIP) in the provision of mass market voice services demonstrates that there is no natural monopoly with respect to such services, and that mass market switching is not a bottleneck monopoly facility; thus, any alleged barriers to entry from the lack of unbundled access to switching cannot "explicitly and plausibly" be connected to "natural monopoly characteristics," or other structural impediments that would make competitive entry wasteful.[146] Further, the presence of such competition also proves that competitors have alternate sources for switching services — either via self-provisioning or leasing from third parties.[147]

The Commission should render its conclusion that there is no impairment on a national basis. As demonstrated herein, switching is not geographically limited. Thus, any differences in the availability of alternate sources of this network element in particular geographic locations become irrelevant, as competitors can, and frequently do, utilize distant switches to process traffic. Absent meaningful distinctions between geographic areas, the Commission may render its determination on a nationwide basis consistent with *USTA I and USTA II*.

Finally, even if the Commission does not render a national finding of no impairment for mass market switching, it should conclude that competitors are not impaired without switching

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146 *USTA II*, 359 F.3d at 571-73 (internal citations omitted).

147 *TRO*, 18 F.C.C.R. at 17247-48, para. 436.

as a UNE in Qwest's region based upon the commercial agreements that Qwest has reached with respect to switching services. The *USTA II* decision requires that the Commission consider "alternatives offered by the ILECs" when determining whether competitors are impaired without access to a particular network element pursuant to Section 251.[148] Such alternatives are not limited to tariffed offerings of the ILECs, but encompass all "services ... [ ] ... available from ILECs outside § 251(c)(3)."[149] As described below, Qwest provides such an alternative with respect to mass market switching — it offers this function to competitors throughout its region independent of Section 251. Specifically, Qwest has entered into commercially negotiated agreements with six CLECs for the continued provision of mass market switching services at mutually acceptable rates, terms and conditions. The same agreement is available upon request to all carriers within Qwest's region. These commercial agreements are conclusive evidence that competitors are not impaired without unbundled access to mass market switching pursuant to Section 251 of the Act.[150]

1. Mass Market Switching Does Not Involve a Structural Impediment to Entry Tied to Natural Monopoly Characteristics

USTA II mandates a national finding of no impairment with respect to mass market switching because a crucial element of the impairment standard cannot be satisfied. As demonstrated herein, the mass market voice services sector does not exhibit the characteristics of a natural monopoly, and mass market switching is not a bottleneck monopoly facility. Thus, any

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148 *USTA II*, 359 F.3d at 577 ("What the Commission may not do is compare unbundling only to self-provisioning or third-party provisioning, arbitrarily excluding alternatives offered by the ILECs.")

149 *Id.*

150 *See* Section III.A.4, *infra.*

alleged harm from a lack of access to this element as a UNE cannot be tied to structural barriers that arise from the existence or the vestiges of a natural monopoly market.

When the Commission first adopted rules to implement Section 251 in 1996, and even more recently when it adopted the *TRO*, the Commission viewed the ILECs' circuit switches as a necessary element to which competitors must have access in order to promote viable competition for mass market voice communications.[151] Competitive conditions and technology have changed dramatically since that time. There is extensive competition, which demonstrates that mass market voice services is not a natural monopoly market, because other carriers have been able to enter the market and compete effectively in the provision of those services. This competition also demonstrates that mass market switching is not a bottleneck monopoly facility, because those competitors are providing mass market voice services largely using self-provisioned or third-party-provisioned switches. In other words, competitors do not need access to ILEC elements as UNEs because other options exist. These competitive data preclude a finding of impairment with respect to mass market switching, because any alleged impairment cannot be tied to structural barriers that would make competitive entry by a reasonably structured and financed competitor wasteful, as required by *USTA II*.[152] The Commission's new rules must reflect these technological and competitive changes.

a. Competition for Mass Market Voice Services is Thriving, thus Demonstrating that the Mass Market Voice Sector is Not a Natural Monopoly

Competition in the provision of circuit-switched mass market voice services has grown substantially, as evidenced by the fact that competitors have deployed a vast number of circuit

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151 *TRO*, 18 F.C.C.R. at 17263-64, para. 459.

152 *USTA II*, 359 F.3d at 572.

switches throughout the nation. CLECs have deployed 1,200 circuit switches, up from 65 in 1996, in wire centers serving 86 percent of the RBOCs' access lines.[153] Cable operators also are providing circuit-switched services. Currently, 17 million homes have access to circuit-switched cable telephony, up from none in 1996 and 10 million in 2002.[154] These CLECs and cable operators have completely bypassed the ILECs' circuit switching equipment, and the instances of such bypass continue to grow.

Intermodal competition for mass market voice services also has flourished. Technological advancements enable competing carriers to provide mass market voice services using packet — as opposed to circuit — switches over broadband transport facilities.[155] Traditional CLECs and IXCs (*e.g.*, AT&T, Covad, McLeod, MCI and Z-Tel), cable operators (*e.g.*, Cablevision, Charter, Comcast, Cox, Time Warner), and new VoIP-based providers (*e.g.*, Net2Phone, Vonage, voiceglo, VoicePulse, Packet8) have taken advantage of these developments and are providing voice services to both enterprise and mass market customers using packet switches and VoIP technology.[156] CLECs have deployed 8,700 packet switches, up from fewer than 75 in 1996.[157] Currently, 90 percent of American homes have access to VoIP services over broadband facilities.[158] These competitors also have bypassed the ILECs' circuit switching equipment.[159] There is wide agreement that VoIP provides comparable or even superior quality and functional-

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153 *UNE Fact Report*, §I, pp. 1-2.

154 *Id.*, §I, p. 2.

155 *Id.*, §I, p. 1.

156 *Id.*, §I, pp. 6-8.

157 *Id.*, §I, p. 2.

158 *Id*, §I, p. 1.

159 In many instances, these competitors also bypass the local loop — provisioning their VoIP services over a separate broadband facility into the end-user's premises.

ity compared to typical wireless service — which is acceptable to price-sensitive customers who assign more value to the superior features that digital service can offer.[160]

Wireless service providers are an additional source of intermodal competition. More than 97 percent of U.S. counties are served by three or more wireless operators; more than 87 percent have five or more wireless options.[161] Wireless providers deploy their own network, including switches, entirely independent of the ILEC network. The extent of wireless competition has increased dramatically since such competition was essentially dismissed in the *TRO*.[162]

As demonstrated in Section II, *supra.*, these intermodal competitors have flourished in Qwest's region, in particular, but also in all ILECs' service areas. The fact that there are facilities-based intermodal competitors providing mass market voice services, and that those carriers continue to deploy facilities and experience an ever-increasing market share without access to ILECs circuit switches, firmly establishes that the mass market voice services sector is not a natural monopoly, and that mass market switching is not a monopoly bottleneck facility. The existence of these competitors precludes a finding of impairment, since any alleged impediment associated with the lack of unbundled access to switching cannot be tied to a structural impediment that would make entry into the market wasteful.[163]

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160 *UNE Fact Report*, §II, p. 21.

161 News Release, "*FCC Adopts Annual Report on State of Competition in the Wireless Industry*," WT Docket No. 04-111 (rel. Sept. 9, 2004); Wireless Telecommunications Bureau Report to Congress, Ninth Annual CMRS Report (rel. Sept. 9, 2004).

162 *UNE Fact Report*, § II, p. 27.

163 Qwest notes that the D.C. Circuit reached this same conclusion, and found that there is no suggestion that mass market switches exhibit declining average costs in the relevant markets, or even that switches entail large sunk costs. *USTA II*, 359 F.3d at 569.